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# Foreign Economic Trends and Their Implications for the United States

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VENEZUELA

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## KEY ECONOMIC INDICATORS

| | 1986 | 1987 | 1988 | % Chg 87-88 |
|---|---|---|---|---|
| National Income (Bs millions) | | | | |
| GDP at current prices | 493,765 | 719,423 | 895,400 | 24.5 |
| GDP at 1984 prices | 336,014 | 350,047 | 364,748 | 4.2 |
| GDP per capita (in 1984 Bs) | 18,772 | 19,036 | 19,505 | 2.4 |
| Disposable National Income | 434,169 | 637,585 | N.A. | |
| Central Gov Surplus/Deficit(-) | -16,700 | -37,445(a) | -35,791 | 4.5 |
| Public Sector Surplus/Deficit(-) | -21,500 | -18,146(a) | -43,895 | -141.2 |
| Net Domestic Investment | 49,070 | 75,734 | N.A. | |
| Population & Labor (000) | | | | |
| Population (Jul/Dec) | 17,899 | 18,388 | 18,700 | 1.6 |
| Labor Force (Jul/Dec) | 6,107 | 6,321 | 6,452 | 2.1 |
| Total Employment (Jul/Dec) | 5,478 | 5,785 | 5,785 | 2.9 |
| Unemployment Rate (%) (Jul/Dec) | 10.3 | 8.5 | 7.7 | 9.4 |
| Production | | | | |
| Petroleum/NGL/condensates(000b/d) | 1,884 | 1,810 | 1,858 | 2.6 |
| Aluminum Ingots (000 MT) | 428 | 420 | 430 | 2.4 |
| Steel Liquid (000 MT) | 3,402 | 3,733 | N.A. | |
| Cement (000 MT) | 4,439 | 4,971 | 6,199 | 24.7 |
| Motor Vehicle Sales (000 units) | 150 | 111 | 123 | 10.8 |
| Construction Permits Granted (b) | 3,762 | 3,080 | N.A. | |
| Money & Prices (Dec 31) | | | | |
| Money Supply M2 (Bs millions) | 224,931 | 279,649 | 319,114 | 14.1 |
| Public Extern. Debt ($ millions) | 25,300 | 25,400 | 25,500 | 0.4 |
| Public Domest. Debt (Bs million) | 72,858 | 79,433 | 86,880 | 9.4 |
| Bank Lending Rate (%) (average) | 12.7 | 12.6 | 12.6 | |
| Consumer Price Index (1984=100) | 132.1 | 185.3 | 251.1 | 35.5 |
| Weighted Avg. Off. Exch. Rate | 8.91/$1 | 13.67/$1 | 15.50/$1 | 13.4 |
| Avg. Free Market Exch. Rate | 19.57/$1 | 28.33/$1 | 33.80/$1 | 19.3 |
| Balance of Payments ($ millions) | | | | |
| Merchandise Imports (FOB) | 7,862 | 8,832 | 10,872 | 23.1 |
| Merchandise Exports (FOB) | 9,122 | 10,567 | 10,114 | -4.8 |
| Petroleum Exports | 7,592 | 9,054 | 8,158 | -10.0 |
| Merchandise Trade Balance | 1,260 | 1,735 | -758 | -143.7 |
| Current Account Balance | -1,471 | -1,125 | -4,680 | -316.0 |
| Current-Capital Account Balance | -3,875 | -1,166 | -4,409 | -278.0 |
| Central Bank Reserves (Dec 31) | 9,858 | 9,376 | 6,584 | -29.7 |
| U.S.-Venezuela Trade ($ millions) | | | | |
| U.S. Exports to Venezuela (FAS) | 3,137 | 3,560 | 4,573 | 28.5 |
| U.S. Imports/Venezuela(FOB) | 5,076 | 5,579 | 5,228 | -6.3 |
| U.S.(%)Share/Venezuelan Exports | 55.6 | 52.8 | 51.7 | |
| U.S.(%)Share/Venezuelan Imports | 39.9 | 40.3 | 42.1 | |

Main U.S. Exports (1988): machinery, transport equipment, auto parts, chemicals, wheat, feed grains. Main U.S. Imports (1988): crude oil & products, aluminum, steel products, iron ore, cement, gold, shellfish, tuna, coffee.

Notes: (a) borrowing not included; (b) private sector.
Sources: Venezuelan Foreign Trade Institute and Central Bank.

SUMMARY:

Overall economic growth increased 4.2 percent in real terms in 1988 compared with 3 percent in 1987. Growth was led by increases in the agriculture, mining, construction and transport sectors. Unemployment, according to government figures, fell from 8.5 percent in December 1987 to 7 percent in December 1988. The government pursued a stimulative fiscal policy which resulted in a deficit of 7 percent of gross domestic product (GDP). The official 1988 inflation rate was 35.5 percent. Inflation was partially repressed by widespread government price controls, government subsidies, the freezing of prices of public sector goods and services, increased imports, and successful government resistance to calls for a general wage increase.

The apparent prosperity in 1988 was due largely to government economic policies, mainly a large fiscal deficit and a rundown of revenues. In spite of a downturn in petroleum export revenue, the government permitted a 23 percent increase in imports. The result was the first trade deficit in 10 years, an unprecedented balance-of-payments deficit. International reserve levels would have declined further had not the government slowed down trade finance payments owed to local banks. Demand was fueled by the government's maintenance of negative domestic interest rates and a multiple exchange rate system, which overvalued the official bolivar.

The new government, which took office February 2, 1989, wasted no time in signaling that it would make a dramatic departure from the economic policies of its predecessor. It has signed a letter of intent with the IMF, is negotiating long-term IMF and World Bank financial assistance, has eliminated the multiple exchange rate system and replaced it with a unified floating rate; lifted price controls on most products; approved large price increases on many public sector products and a wage increase for public sector employees; deregulated domestic interest rates and pledged to overhaul the trade regime. These changes in economic policy, which were perceived as sharply eroding local living standards, sparked social disturbances in late February. The U.S Government disbursed a $450 million bridge loan in March. The new government continued suspension of principal payments on the public sector commercial bank debt, and it is negotiating a new debt agreement with the commercial banks.

For U.S. exporters, Venezuela will continue to be a significant market. In 1988, U.S. exports to Venezuela amounted to nearly $4.6 billion, making Venezuela the second largest market for U.S products in Latin America. However, the economic adjustments under way in the economy are expected to lower growth and increase inflation rates this year. Consequently, imports are expected to decline. Additionally, while U.S. exporters have enjoyed a traditionally large market share, they are faced with increased competition from European and Japanese suppliers, especially in major projects.

INTERNAL ECONOMY:

The Venezuelan internal economy grew 4.3 percent in 1988, the fourth consecutive year of expansion. Government activity and policies played a significant role in producing last year's moderate growth. The mining, construction, and transport sectors enjoyed significant above-average growth.

The administration maintained a stimulative fiscal policy which was financed by increased internal borrowing and a sharp drawdown of treasury reserves. In spite of a downturn in petroleum based government revenue, the chief revenue source of the government, both current expenditures and public investment increased about 15 percent, resulting in a consolidated public sector deficit of 7 percent of GDP in 1988.

Government economic policies fueled demand in the private sector. The government froze domestic interest rates well below the inflation rate, resulting in excessive credit demands and a higher propensity to consume. Consumer spending concentrated on the purchase of upper income housing, automobiles, electronics, white goods, and other consumer durables. The maintenance of the multiple exchange rate system led to capital flight, inventory accumulation, and a large loss of reserves.

The government's concern with growing inflationary pressures prompted a restrictive monetary policy in 1988 which resulted in a nominal money supply growth of 14.1 percent (down from 24.3 percent in 1987) contrasted with an official inflation rate of 35.5 percent. A strong drain on liquidity was the more than doubling of the bolivar payments for private sector imports in 1988 compared with 1987. Another factor keeping liquidity tight was that, in spite of increased Central Bank support to the financial system, bank credit expanded at below the inflation rate due to an inadequate increase in deposits. The government also partially repressed inflation in 1988 by freezing prices on government-produced goods and services, resisting pressures for a general wage increase and granting few increases on price-controlled items produced by the private sector.

The new government, elected in December 1988 and in power since February 2, 1989, quickly signalled its intention to depart from the economic policies of its predecessors. It abolished the multiple exchange rate system and replaced it with a single floating exchange rate; lifted price controls on most private goods and services, with the exception of a few items placed in a basic basket of goods which will remain subject to price controls; sharply increased utility, energy, and transport prices; raised the minimum wage and public sector wages; and increased domestic interest rates.

The initial result of these policy shifts has been a dramatic increase in the inflation rate. Inflation in March hit an unprecedented 21 percent. However, it is expected that these measures in the medium term will reduce the fiscal deficit, will increase competitiveness of local industry, will stimulate nontraditional exports; and will restore the balance-of-payments equilibrium. Most observers discount the government's projection of a 1989 inflation of 40 percent, believing that inflation will be at least 60 per cent. Most private observers are predicting a recession in 1989. There are some early signs that tend to confirm recessionary fears, including declining sales in leading industries such as the automobile and construction industries. At the end of March, the stock market registered an 18 percent decline, compared with the 1988 close. Labor leaders report large layoffs in February-March due to the new economic policies. At the end of February, Venezuela experienced for a few days unprecedented social disturbances, including widespread looting in some localities in Caracas and a few other cities. Order was restored within three to four days.

BALANCE OF PAYMENTS

Venezuela ran a $760 million trade deficit in 1988, its first in 10 years. Total exports were off 4.3 percent, as a 17 percent decline in the unit value of petroleum receipts more than offset a 29 percent increase in nontraditional export income. Imports increased a surprising 23.1 percent.

The current account registered an unprecedented deficit of $4.7 billion equal to 8.1 percent of GDP, compared with the 1987 deficit of $1.3 billion or 2.6 percent of GDP. Interest payments on Venezuela's external debt totaled $3.1 billion. The capital account remained slightly positive due to large short-term capital flows. Capital payments on the external debt totaled $2 billion in 1988, an amount roughly equal to 1987 levels.

Central Bank reserves fell to $6.2 billion at the end of 1988 from $9.4 billion at the end of 1987. Central Bank reserve loss was lessened by transfers of $850 million from the Venezuelan Investment Fund. Total reserves at the end of 1988 totaled $7.1 billion, an amount equal to 7.9 months of imports. A $500 million Bank of International Settlements swap agreement prevented 1988 reserve loss from being even higher.

In the generally sombre balance-of-payments position in 1988, there were two bright spots. In 1988, Venezuela successfully reentered the international bond market with four placements totaling $356 million. The Venezuelan Government sold $301 million in nonmonetary gold in 1988, thereby converting gold into the second largest nontraditional export after aluminum.

In February 1989, the Venezuelan Government signed a letter of intent with the IMF (thereby enabling the government to draw in April a $453 million first credit tranche), and it is negotiating a three-year, $5 billion, extended financing facility (EFF) with the IMF. Two large structural adjustment loans are being negotiated with the World Bank. In March, the U.S. Government provided a $450 million bridge loan to Venezuela. The expected inflow of significant multilateral finance, coupled with an expected reduction in imports and debt service payments and some improvement in export earnings, should enable Venezuela to significantly improve its balance-of-payments position in 1989.

EXCHANGE AND IMPORT CONTROLS

The government has replaced the multiple exchange rate system with a single floating rate initially set at the prevailing free market rate. This meant an immediate 170 percent devaluation of the official Bs 14.50/$1 exchange rate. After the exchange rate was unified in March, the bolivar has strengthened slightly and is currently at Bs 37/$1. Foreign exchange is to be allocated according to supply and demand, with the Central Bank of Venezuela setting reference prices and intervening in the market only to keep the exchange rate within a desirable range of fluctuation.

The unified exchange rate applies to all transactions, with some transitory exceptions being granted to some outstanding letters of credit (L/Cs) and possibly some older private sector debt. The government has decided to partially recognize the exchange rate guaranteed in L/Cs of credit used to finance imports that were nationalized (customs duties paid) during June 1 - October 31, 1988. Local banks and the Venezuelan financial authorities are expected to provide longer bolivar financing terms for the companies negatively impacted by this measure. The government has not announced the new system that is to apply to private sector debt repayments.

The government has announced that it will "rationalize" the tariff system within 360 days. Quantitative restrictions are expected to be progressively reduced and eliminated. Tariff levels are to be made more uniform and the average tariff rate is to be reduced. The widespread practice of tariff exemptions is expected to be eliminated. Prior exchange authorizations(conformidades) and preshipment inspections have been eliminated.

FOREIGN DEBT

As of December 1988, Venezuela's external public sector debt was $25.5 billion. Private sector debt totaled an additional $4.5 billion. Outstanding external debt represented 58.2 percent of

GDP. Approximately 90 percent of Venezuela's outstanding debt is owed to commercial banks. During 1983-88, Venezuela was considered a model debtor as it repaid $35.2 billion, including principal payments totaling $15.7 billion. In 1988, Venezuela's debt service equalled 45 percent of exports.

In January 1989, the outgoing Lusinchi government, citing mounting balance-of-payments problems due to depressed oil earnings, notified the commercial banks that it would defer principal payments on the public sector commercial bank debt and renegotiate the terms of the current foreign debt agreement, which is widely viewed as being less favorable than agreements signed by other Latin American governments.

In February, the new government notified the commercial banks that principal payments on private sector commercial bank debt would be suspended as well, and that private sector debt would be included in the overall debt negotiations. Interest payments on the external debt have slowed down, and the government has told the commer- cial banks that, while it aims to keep interest payments current, actual disbursements will depend on cash flow. By April, interest arrearages accumulated since February totaled several hundred million dollars.

The government has two major objectives in the current negotiations with the commercial banks. The short-term objective is to obtain new money in 1989 to meet the immediate balance-of-payments financing gap. The government has requested $2 billion, including a $600 million bridge loan. The government's second objective is to achieve a significant reduction in outstanding debt via a possible combination of cash buy-backs, debt-for-bond swaps, debt-equity swaps and exit bonds, all at discounts from nominal debt value.

For several years, Venezuelan President Carlos Andres Perez (CAP) has called on debtor countries to "concert" strategies and agree with creditors on the framework within which each country would negotiate the best deal possible. Perez has made it clear that he intends to use various world fora, including the Group of Eight, to push for new terms on the debt in accordance with the "economic realities" of the individual debtor country. He has called for a multilateral debt agency to purchase Third World debt at a discount. During the February outburst of civil unrest, Perez placed part of the blame for the explosion of frustrations on the external debt.

## PETROLEUM, PETROCHEMICALS, AND COAL

Venezuela continues to be heavily dependent on petroleum revenues. In 1988, petroleum accounted for almost 20 percent of GDP, over 50

percent of central government revenue, and about 80 percent of export earnings. Preliminary figures show that in 1988 Venezuela exported an average of 1.618 million barrels of oil per day at nearly $13.42 per barrel. Earnings for 1988 petroleum exports are estimated at $8.15 billion, almost $1 billion below 1987 but up sharply from the $7.6 billion earned in 1986. Crude reserves remain at about 58 billion barrels, but with large increases in the proportion of light and medium crudes.

During 1988, Venezuela continued the policy initiated in 1986 of shifting from being simply an exporter of crude and products, to being primarily a seller of products refined in various locations. This shift reflected the big expansion of its overseas refining operations during 1985-86 through new joint ventures and the leasing of the Curacao refinery. The "internationalization" program of 50-50 joint ventures in consuming countries now includes Veba (Germany), Nynas (Sweden), Citgo, Champlin and UNOCAL (U.S.). In 1988, PDVSA purchased the remaining half of the Champlin refinery. A letter of intent to purchase UNOCAL has been signed and a final agreement is expected in the second half of 1989.

In 1988, PDVSA continued to react to the volatility of international prices and overproduction by some OPEC member countries by imposing a premium on some of its light and medium crudes. During the year, Venezuela continued to increase production of condensates, reaching a level of over 165,000 barrels per day. However, adjustments to condensate production may be required as OPEC may define condensates as light crudes and therefore part of the quota. In 1988, 55 percent of Venezuela's oil exports went to the United States; shipments to Europe took 14 percent of total exports.

Venezuela's 1988 proven reserves of 58 billion barrels were about the same as 1987, but over 90 percent more than 1986. The huge 1986 increase in proven crude oil reserves occurred when Venezuela upgraded previous estimates of existing reserves, particularly heavy and extra-heavy crudes from the Orinoco Heavy Oil Belt (Faja). But in 1986, 1987, and 1988, there were significant discoveries of light and medium crudes, reflecting recent emphasis on exploration for these lighter grades. Based on the 1988 produc- tion rate, Venezuela has proven crude oil reserves that will last for nearly 100 years.

During 1988, PDVSA's petrochemical expansion focused on Moron, El Tablazo, and the Oriente Cryogenic Complex. There are already about 16 petrochemical mixed enterprises which rely on investment from Pequiven (a PDVSA subsidiary), national and foreign firms, and private investors.

During 1988, PDVSA formed a new subsidiary, Bitumenes del Orinoco, to market Orimulsion (a mixture of heavy oil, water and chemical additives). Also in 1988 PDVSA signed an agreement with British

Petroleum to sell Orimulsion in Europe. Orimulsion will compete with coal rather than with petroleum in the fossil-fuel electric-power market.

Carbozulia (a PDVSA subsidiary) has a joint venture with ENI and Arco Coal (U.S.) to form two companies to export coal. Venezuela has exported coal since 1987.

INDUSTRY, FOREIGN INVESTMENT AND LABOR

Industry: The manufacturing sector grew 3.2 percent in 1988, a slower rate than the 4.4 growth rate recorded in 1987. Capacity utilization declined from 70 percent in the first quarter to 66 percent by the fourth. According to official figures, private sector investment fell from 8.7 percent of GDP in 1987 to 7.9 percent in 1988. Reflecting a slowdown in demand, order backlogs diminished during 1988 from an average of six months during the first quarter to 5.4 months by the fourth quarter. In spite of increased import levels, private industrial surveys indicate that shortages of imported inputs are still considered to be the biggest constraint to growth.

Negative domestic interest rates and inflationary expectations led to a strong demand for consumer durables in 1988. Automobile sales increased 11 percent in 1988 over 1987 levels and totaled 123,614 units. Other consumer items such as televisions, stereos and white goods were in high demand. Fourth quarter industrial surveys indicated a general slowing in production in most industrial sectors. Bucking this general slowing trend were the textile, chemicals and plastics, pulp and paper, and mining industries. Reflecting a construction boom of upper income housing in Caracas and a significant increase in public investment activity, cement sales in 1988 increased 6.5 percent over 1987. Preliminary figures indicate steel consumption increased 12 percent in 1988. While no final figures were available, iron ore and aluminum production were expected to show production increases in 1988.

Industry surveys indicate that many businessmen expect a downturn in demand in 1989 and are reducing or delaying new investment. There are early signs that the economic slowdown in the last quarter of 1988 has become more pronounced in early 1989. Automobile sales plummeted 73 percent during the first three months of 1989, compared to the same period in 1988. Construction industry representatives, noting the sharp increases in new mortgage interest rates, are predicting a recession in the construction industry. Imports by the private sector in early 1989 were very weak, reflecting both uncertainty as to whether industry can pass on increased import prices to the consumers hit by high inflation rates, and also a drawdown of inventories accumulated in 1988.

Additionally, due to the government's decision to only partially recognize the guaranteed exchange rate in outstanding L/Cs, the private sector will have to generate an estimated additional Bs 50 billion to pay $6 billion in outstanding L/Cs.

Foreign Investment: Registered foreign investment at the end of 1988 totaled $1.9 billion, with 60 percent accounted for by U.S. investors. Despite a significant liberalization of investment regulations in September 1986, new foreign investment increased only $83 million in 1988, although companies operating here reinvested much of their earnings. Most companies have adopted a wait-and-see attitude with respect to new foreign investment. On the positive side, the March 1989 unification of the exchange rate at the free market rate removed a deterrent to foreign investment. Also in March 1989, the government modified regulations governing the conversion of public sector debt to equity. The new debt-to-equity regime allows for the first time national investors to participate in debt-equity swaps and explicitly notes that the government will negotiate to obtain some of the market discount on the traded debt. While the debt-equity program has enjoyed only modest success to date, several large public debt-equity swaps are under negotiation.

Labor: Relations between labor and management remained good in 1988, but the future is uncertain. Negotiations continued to be characterized by tough bargaining, the exclusion of government from negotiations, and very infrequent use of the strike.

In general, 1988 was marked by increasing nervousness about the effect of inflation on labor-management relations. For the second straight year Venezuela experienced inflation in the 35-40 percent range; an event without precedent in the last several decades of the country's history. Since three years is the standard period for a labor contract and since built-in wage increases during the latter years of the contracts were made on the assumption that inflation rates would remain low, unionized workers suffered unprecedented declines in their living standards. With prices rising rapidly and unemployment apparently increasing in the first few months of 1989, prospects for the remainder of the year are for heightened labor-management tensions. The unemployment rate dropped to 7 percent at the end of 1988. However, of the almost 170,000 jobs created during the first half of 1988 (the latest period for which detailed statistics on the labor force are available), 25 percent occurred in the public sector and at least another 30 percent came in the informal sector. Labor force participation rates for both men and women continued to rise, and by mid-1988 the average rate, 56.6 percent, had jumped by four-tenths of a percent during the

preceding 12 months. The official measurement of participation in Venezuela's informal economy has remained a constant 35-37 percent of the labor force since early 1981.

## AGRICULTURE

In 1988, agriculture in Venezuela continued to follow the policies set by the Lusinchi administration in 1983: high subsidies, preferential exchange rates and low interest rates. These policies, which have expanded agricultural output by nearly a quarter in the preceding four years, also continued to work in 1988, with another gain of around 4 percent.

The new government has indicated its desire to move to freer markets by reducing subsidies and allowing higher producer prices. It will have to balance the constant demands of farmers for higher prices against the social consequences the higher food prices can bring. The traditional solution to this dilemma, to subsidize both farmer and consumer, probably will not continue because the country lacks fund to carry such heavy costs.

So far, the government's food policies have had strong inflationary effects in the form of higher prices for most agricultural products. Food imports will likely drop in response to higher prices. U.S. food shipments, which reached $683 million in 1988, will perhaps fall by as much as 10 percent. Still, the country will be far from self-sufficient, and imports will continue to be an essential part of the nation's food supply. Credits for imports, such as the U.S. Department of Agriculture's credit programs, could play an important part in meeting the country's financial needs during the coming two or three years.

## IMPLICATIONS FOR U.S. TRADE

Because of recent rapid changes in Venezuelan economic policy, market opportunities vary from sector to sector. After a period of adjustment, there should be good prospects for raw materials, intermediate goods, capital equipment and parts, especially for the petroleum, petrochemical, manufacturing, and agricultural sectors.

Adjustments to the import regime, which are anticipated during 1989, may have an impact on prospects for consumer goods, depending, of course, upon prices and availability of foreign exchange. U.S. suppliers are experiencing increased competition from European and Japanese suppliers, who perceive Venezuela as an excellent long-term market. There should be many opportunities

for aggressive American businesses, particularly those who take a long-term view. The U.S. share of Venezuelan imports has traditionally been in the 40 percent range.

Several major projects, planned or begun during 1988, will move forward during 1989. There are increased opportunities for equity partnership in a variety of sectors. Major projects offer opportunities not only to major contractors, but also to U.S. suppliers of materials and equipment. Competitive financing remains a critical factor.

In many of the following projects, good opportunities remain for subcontractors and suppliers:

| PROJECT | COMPANY |
|---|---|
| Aluminum smelter/lamination expansion | Alcasa |
| BTX plant | Corpoven |
| Bauxite mining development | Bauxiven |
| Alumina plant expansion | Interalumina |
| Polypropylene plant | Propilven |
| Ammonia plant | Nitro-Oriente |
| MTBE plant | Superoctanos |
| Orinoco pulp & paper project | Pulpa Orinoco |
| Aqueduct project, central Venezuela | INOS |
| Linear polyethylene | Pequiven/Grupo Zuliano |
| Macagua II hydroelectric dam | Edelca |
| Olefins - ethylene/propylene | Pequiven |
| Chlorine/caustic soda plant | Pequiven |
| MVC/PCV | Pequiven |
| Propylene/polypropylene | Petropropanos |
| Ethylene oxide/ethylene glycol | Pralca |
| Gold production/processing facilities | CVG/Minerven/Venorca/ foreign investors |

Companies interested in this market are urged to contact the U.S. Embassy to obtain information on bid opportunities which may not be publicly advertised and to identify local representatives. Information is also available from the U.S. Department of Commerce in Washington, D.C.